THE REVENUE ACT OF 1921

The Revenue act of 1921 became law November 23, 1921. It repeals the federal excess-profits tax, the transportation taxes, some luxury and other taxes, reduces slightly the maximum surtaxes upon individual incomes and increases somewhat the personal exemptions of heads of families and dependents, permits net losses of one year to be offset against net income of following years, and provides for the final settlement of tax cases besides making some other changes in the previous statute. The new act is the result of a rather long and spirited contest between those who desired to reduce the rates of the Revenue act of 1918 upon large incomes, profits and wealth and those who opposed such reductions or who, at least, opposed the shifting of greater burdens upon the masses through sales and other taxes.

The passing of the Revenue act marked the end of the extraordinary session of Congress which President Harding called to meet April 11, 1921, for the purpose of revising the federal revenue and tariff laws. Twice before, President Wilson had urged Congress to revise the Revenue act of 1918 but his words fell upon the ears of a Congress dominated by a hostile party which evidently decided that it could enact revenue and tariff laws to its own liking much better after it had secured control of the executive as well as of the legislative branch of the government. With the Republican landslide of November, 1920, the desired control became overwhelming and soon after the inauguration in March the extra session was called.

Before Congress met there was disagreement as to whether the revenue or the tariff bill should be taken up first. The agricultural and industrial depression had become very serious and the complaints of the business classes about heavy taxes, particularly about excess-profits taxes, were growing in magnitude. The urgent request for the revision of the revenue law had been made not only by the preceding Democratic President and his Secretaries of the Treasury and now by the new Republican President and his Secretary of the Treasury but also by nearly all of the Republican leaders in and out of Congress, the press of the country, and an organized propaganda that appeared to have the unlimited financial backing and moral support of the business interests of the nation.

But notwithstanding all of this pressure for tax revision, the Ways and Means Committee postponed the introduction of a new revenue measure until the House had drafted, debated and passed not only the Emergency Tariff but also the so-called "Permanent" Tariff bill. Those conversant with the personnel of the Ways and Means Committee and the interests which it represents could easily have guessed

that the tariff would be taken up before matters of internal revenue in view of the then prevailing circumstances. Significant among these circumstances were the economic depression weighing especially heavily upon the farmers and the persistence of the belief among the "Old Guard" and their naive disciples that the tariff is the panacea for economic ills.

Consequently, it was not until August 15 that Chairman Fordney introduced the revenue bill into the House. It was referred, as a matter of form, to the Ways and Means whose chairman had introduced it, the next day it was reported back to the House, without change, and four days later it was passed by the House. Shortly thereafter Congress recessed for four weeks and the Senate Finance Committee took up the consideration of the bill.

The progress of the bill through the Senate was quite different from that in the House. In the first place, the Senate Finance Committee shelved the consideration of the "Permanent" Tariff bill and undertook to rewrite the revenue bill. Most of its changes were, however, merely in matters of form and phraseology. When the bill reached the floor of the Senate, a real contest began. A number of western Republican senators together with Democrats representing agricultural and allied interests formed what is generally known as the "agricultural bloc" or the "progressive and agricultural bloc." This bloc in combination with the nearly solid Democratic minority in the Senate refused to accept the bill as passed by the House or as proposed with minor changes by the Finance Committee. The chief contests were over the rates of the surtax upon individual incomes, the maximum rates of the tax upon estates, the rates of the income tax upon corporations, the repeal of the excess-profits tax and the adoption of a comprehensive sales tax. This bloc forced its amendments upon the Senate and won over the support of the House on the surtax rates in spite of the urgent but contrary recommendations of the President and the Secretary of the Treasury.

Had this stage been reached early in the session, the contest might not have been interrupted with adjournment. But senators and representatives were doubtless weary and had little hope of a much more satisfactory compromise at that time. Furthermore, it was time that both taxpayers and administrative officers should know certainly what taxes were to be levied upon income and profits, at least, upon those of 1921. Another possible consideration was that a few more days would have run the extra session into the regular session with less excuse for the Congressional mileage of 20 cents per mile between Washington and the homes of the respective members. Consequently, the Senate accepted the conferees' report, the President approved it

and Congress adjourned on the eve of Thanksgiving. The leaders of each of the contesting parties as well as the nation at large had cause to be thankful that the law was no worse than it was.

It was generally understood by everybody even before the elections of 1920 that federal expenditures and tax burdens were to be reduced. There was no real problem in reducing taxes if expenditures could be kept down but nobody seemed able or willing to cut expenditures to such a point that taxes would be light. The interest on the war debt alone amounts to nearly a billion dollars a year, more than the current ordinary expenditures of the federal government before the war. Not only the Navy and the War Departments, but nearly every branch of the government had expanded very greatly during the war and few have been got back to the pre-war status. Nor is there much probability that many of them will ever be got back to such a status.

The total ordinary expenditures prior to the war were about a billion dollars or, if postal expenditures which were offset by postal receipts are excluded, about three quarters of a billion dollars a year. In the fiscal year of 1920 ordinary expenditures were nearly 6½ billions, and in 1921 over 5 billions of dollars.[1] On April 30, 1921, Secretary Mellon estimated that the total ordinary disbursements for the fiscal year 1922 would be $4,565,877,033, of which it was estimated that $3,700,000,000 should be raised by internal revenues. Accompanying these estimates were recommendations that:

(1) The excess-profits tax should be repealed and the loss in revenue made good by increasing the tax on corporations by 5 per cent and repealing their exemption of $2000,

(2) The combined normal and surtaxes upon incomes be reduced to about 40 per cent for 1921 and to about 33 per cent thereafter,

(3) The miscellaneous specific-sales taxes and excise taxes, including the transportation tax, the tobacco taxes, the tax on admissions and the capital-stock tax be retained but that the minor so-called "nuisance" taxes on fountain drinks, etc., be repealed,

(4) New or additional taxes such as stamp taxes, or a license tax on the use of automobiles, be imposed so as to bring total receipts from internal revenues up to $4,000,000,000, unless Congress cut expenditures $250,000,000 to $350,000,000, or levied additional levies upon staple imports,

(5) The administrative provisions of the law be simplified and provision made for the final determination and settlement of tax cases.

On August 4, the tariff bills having been passed by the House and the revenue bill being under consideration by the Committee on Ways and Means, Secretary Mellon appeared before the committee with revised estimates and recommendations. In the meantime the Budget bill had been passed and General Dawes had been appointed Director

[1] *Annual Report of the Secretary of the Treasury for 1921*, p. 154.

of the Bureau of the Budget. The new estimate of expenditures for 1922 was practically the same as that of April 30 though it was suggested that if a revised tariff bill should become effective about December 31, 1921, it might increase revenues by about $70,000,000 over the $300,000,000 that was expected from the existing law in 1922 and by about $150,000,000 in 1923, fiscal years in each case. Secretary Mellon repeated his former recommendations about surtaxes, corporation taxes, taxes on ice cream, soda fountain drinks, etc., but changed his recommendations relative to transportation taxes which he now suggested might be reduced one half by Jan. 1, 1922, and repealed entirely a year later. At the same time, he recommended additional taxes, increased documentary stamps, a stamp tax of 2 cents on bank checks, an increase of first-class postage from 2 to 3 cents per ounce, an annual federal license tax upon motor vehicles to average about $10 per vehicle and to be graded according to power, and increases in the taxes upon cigarettes and other tobacco products.

These recommendations brought a storm of protest from the country. President Harding, Secretary Mellon, Chairman Fordney and other party leaders held a conference on August 9 and the next day Secretary Mellon sent Chairman Fordney a new set of estimates which reduced those of the week before by $350,000,000 and which also suggested that the Treasury would borrow $170,000,000 through certificates of indebtedness and also try to increase its receipts from the salvaging of war material, particularly in the War Department, the Navy Department and the Shipping Board. The hope was also expressed that additional receipts might be got from a new tariff law to become effective by December 31, 1921,[2] and that $3,000,000,000 from internal revenue would be adequate for the calendar year 1922.

Senator Simmons of the Finance Committee characterized the Treasury's suggestion of borrowing $170,000,000 in order to cut down taxes as "unbusinesslike," "unstatesmanlike," "a smart expediency," a "subterfuge," and a "reprehensible method of meeting the financial obligations of the government." Referring to the further cut of $350,000,000 in expenditures as outlined in the conference of administration leaders he charged that the authorized appropriations still stood, that no revocation of the authorization for the payment of these amounts had been proposed and that it was safe to assume that they would be expended, and that if any technical savings were realized that they would have to be taken care of in a deficiency bill.[3]

[2]The "Permanent" Tariff has not yet been passed. Changes in economic and international conditions make the problem a very difficult one and party councils have been divided as to what is wise politically in view of the approaching elections.

[3]Senate Report, no. 275, 67 Cong. 1 Sess., part 2, p. 5.

Federal Receipts and Expenditures, 1913-1915 and 1920-1923.[1]

(In millions of dollars.—Estimates for 1922 and 1923.)

Fiscal year	Customs	Internal revenue collections									Total ordinary	
	Receipts	Tobacco	Distilled spirits and fermented liquor	Income and profits tax and corporation capital stock	Transportation telegraph, telephone etc.	Estate tax	Special sales taxes—manufactures, consumers, dealers, beverages, soft drinks, etc.	Stamp	Admissions and dues	Miscellaneous	Total internal revenue	Receipts	Disbursements
1913	$319	$77	$230	$35						$2	$344	$724	$725
1914	292	80	226	71						2	380	734	735
1915	210	80	224	80				$23		8	416	696	761
1920	324	296	140	4,050	$289	$104	$319	88	82	40	5,408	6,695	6,482
1921	308	255	83	3,310	302	154	282	76	96	38	4,595	5,625	5,538
1922	275	250	60	2,185	162	150	224	58	95	30	3,214	3,968	3,993
1923	330	250	60	1,790	27	150	188	46	80	20	2,611	3,345	3,513

[1] *Annual Report of the Secretary of the Treasury for 1921* (on basis of daily Treasury Statements).

Senator Penrose[4] estimated that the bill as agreed to in conference and later approved would yield $3,216,100,000 in the fiscal year 1922 and $2,611,100,000 in the fiscal year 1923. He estimated that the receipts would exceed expenditures by $16,000,000 in 1922 but said it was impossible to make an accurate forecast for 1923.[5] The accompanying table shows the actual receipts and expenditures for three pre-war years, for 1920 and 1921, and also the estimates of the Secretary of the Treasury for the fiscal years 1922 and 1923.[6]

The Revenue act of 1921 follows very closely the Revenue act of 1918. As has been said, the latter act "was repealed with certain exceptions and then reënacted with certain changes." Senator Smoot, although dissatisfied with the bill, said in criticizing its critics, "When the bill becomes law it will be the present revenue baby merely dressed in pink instead of red."[7] A comparison of the main sections or "titles" into which the two laws are divided shows no complete changes and partial changes in only three of the fourteen titles.

A brief discussion of some of the more important changes in each of the several titles or sections may be of profit.

Title I—General definitions. Some references to the "present war" which were contained in the Revenue act of 1918 are omitted from the new act but no very significant changes appear to have been made.

Title II—Income tax rates. Perhaps the hardest fought contest during the entire session of Congress was over the surtax rates of this title. The rates of the normal tax, 8 per cent upon net incomes in excess of $4000 per year and 4 per cent on smaller ones, remain unchanged, though there was some attempt to lower them. The increase of the personal exemption for the heads of families from $2000 to $2500 where family net income does not exceed $5000 and of that for children under eighteen and other dependents from $200 to $400 per year does in effect, however, result in reducing normal taxes but not surtaxes. It is estimated that the former will reduce Treasury receipts by $40,000,000 and the latter by $30,000,000 a year.[8]

As mentioned above Secretary Mellon recommended that the maximum of the combined income tax rates be cut from 73 per cent (8 per cent normal plus 65 per cent surtax) to 40 per cent for the current fiscal year and to 33 per cent for succeeding years. With the retention of 8 per cent as a normal rate, this would mean a surtax of 32 per cent for the current year and 25 per cent thereafter. Senator

[4]Senator Penrose died Dec. 31, 1921, after this was written.
[5]*Congressional Record,* Nov. 22, 1921, pp. 8992ff.
[6]*Annual Report of the Secretary of the Treasury for 1921,* p. 12.
[7]*Cong. Record,* Nov. 23, 1921, p. 9073.
[8]House Report, no. 350, 67 Cong., 1 Sess., p. 3.

Smoot stated that the rate of 32 per cent was not merely guessed at but that it was a scientific rate or, rather, "a mathematical calculation. The reason is because 32 per cent is the difference between the income from a tax-exempt security and one that is taxable on the basis of today's money market."[9] The Ways and Means Committee, the House and the Senate Finance Committee accepted this recommendation which it was estimated would cause a loss of $90,000,000 in Treasury receipts. The Secretary of the Treasury and others argued, both before and after the law was passed, that this reduction in rates would ultimately cause no Treasury loss but rather a gain because of its effect upon business.

In spite of the reductions which had been agreed to before the bill came up for debate in the Senate, the agricultural bloc forced the Finance Committee and the Senate itself to raise the maximum surtax rate from 32 per cent on the bracket of incomes over $66,000 to 50 per cent on the bracket over $200,000. The Senate, under the compulsion of the bloc, changed only slightly the House rates on incomes of less than $66,000 which were exactly the same as the rates on those brackets under the act of 1918, but it did thus materially modify rates on the brackets of income above $66,000 and it also postponed for one year the time for the new rates to take effect, leaving the rates of the old law effective for incomes received in the calendar year 1921 upon which taxes are paid in the calendar year 1922. When the bill was sent to conference, the majority managers for the Senate let the majority managers for the House know that they would be willing to accept a compromise of a 40 per cent maximum for surtaxes. These Senate managers were really not in sympathy with the majority of the Senate which they were supposed to represent and it would have been easy to have thus accomplished their own desires by a compromise had it not been that by this time the sentiment in the House had changed in favor of higher surtaxes than had originally been voted in that body. Consequently, the House instructed its conferees to recede from its proposed maximum of 32 per cent and to accept the Senate proposal of 50 per cent, in spite of very strong pressure from President Harding and other administration leaders for a lower rate.

In the debates on this and other sections of the bill there were many charges of attempting to "soak the rich" or, on the other hand, of favoring the rich with low rates. The Senate Finance Committee stated its argument in part as follows:

> Your committee recommends a reduction of the maximum surtax from 65 per cent to 32 per cent in the belief that in the near future the lower surtax will, by stimulating sales and profit taking, and by making possible

[9] *Cong. Record,* Nov. 23, 1921, p. 9074.

transactions now blocked by excessive surtax rates, not only facilitate needed business readjustments but actually increase the revenue. In the long run in the opinion of your committee the 32 per cent rate will yield more revenue than the 65 per cent rate. The effect of excessive surtaxes in forcing the investment of capital in tax-free securities and in encouraging taxpayers to avoid the tax through the device of gifts, division of their income, refraining from profitable sales, and placing their money in investments which promise well for the future, but yield no immediate return, is clearly brought out in Table B following, which shows the decline in incomes over $300,000 from the year 1916 to the year 1919. During this period the number of taxpayers and the amount of net income returned by the general body of taxpayers greatly increased. But this was not true of the wealthier classes.[10]

TABLE B.—DECLINE OF INCOMES OVER $300,000.[1]

	Number of returns		Net income		Income from dividends, interest, and investments.	
	All classes	Incomes over $300,000	All classes	Incomes over $300,000	All classes	Incomes over $300,000
1916	437,036	1,296	$6,298,577,620	$992,972,986	$3,217,348,030	$706,945,738
1917	3,472,890	1,015	13,652,383,207	731,372,153	3,785,557,955	616,119,892
1918	4,425,114	627	15,924,639,355	401,107,868	3,872,234,935	344,111,461
1919	5,332,730	679	19,859,491,448	440,011,589	3,954,553,925	314,954,884

[1]Senate Report, no. 275, 67 Cong., 1 Sess., p. 5.

Secretary Mellon presses the argument still further in his annual report for 1921.[11] He says:

If we take the taxable income from interest, exclusive of interest on government obligations, the decline is still more striking, the figures being as follows:

Fiscal year	Incomes		
	Over $300,000	$100,000 to $300,000	$50,000 to $100,000
1916	$165,733,900	$158,870,428	$93,280,583
1917	111,468,127	119,539,786	75,375,484
1918	74,610,507	91,030,392	65,784,062
1919	60,087,093	91,467,182	68,814,933

The foregoing brackets represent the incomes subject to surtaxes under the Revenue act of 1918, respectively, at 63 to 65 per cent, 52 to 63 per cent and 29 to 48 per cent. To these figures should be added the normal tax of 8 per cent in order to find the total tax obligation.

[10]Senate Report, no. 275, 67th Cong., 1 Sess., pp. 4 and 5.

[11]P. 21.

In view of these figures, is it not clear that these high surtax rates are rapidly ceasing to be productive of revenue to the government? And is it not equally clear that their effect has been to divert into unproductive channels not merely the income on old investments, but to force a large part of the old investment capital into unproductive channels?

In reply to a previous but similiar statement of Secretary Mellon, Mr. Kitchin, the ranking Democratic member of the Ways and Means Committee, made the following typical statement in his minority report to the House:

Let no man be deceived by this statement. The last report of his Commissioner of Internal Revenue of July 12 shows that it is absolutely untrue. The *fact is that for each year since 1916,* including the years 1918 and 1919, when the existing high surtax rates applied, *there has been a gradual increase of millions in collection of taxes from incomes from $50,000 upward.* In 1919, with the existing high rate on big incomes, were collected $283,000,000 more on incomes of $50,000 and up than were paid in 1917, with lower surtaxes, and collected $586,000,000 more in 1919 than in 1916, with still lower surtax rates. Another reason he and the Republicans give for the reduction is that the millionaires and multi-millionaires with big incomes, on account of the high surtaxes invested their money in tax-free securities such as state and municipal bonds, and thus reduce the taxes on incomes from bonds, etc.

Let no one be misled by this statement and argument. The fact is, that according to the reports of the Commissioner of Internal Revenue since January 1, 1916, including the report of the present Commissioner of Internal Revenue of July 12, in 1919, with the existing high surtax rates, *the total net income from "interest on bonds, notes, etc.," was $564,000,000 more than in 1917,* with much lower surtax rates, and $500,000,000 more than in 1916, with still lower surtaxes. So it seems that with high surtax rates we have had an increased income from interest on bonds, etc. However, even if the millionaires and multimillionaires were putting their surplus income into state, county, and municipal bonds, are not the people of the states and counties and municipalities thereby benefited by getting a higher price for such bonds, and do not the proceeds from these state and municipal bonds go more directly for the benefit of the people than the taxes of the federal government? With the proceeds do not they build public roads, which the people in the states, counties, and cities see and use every day; do they not go to build public schools all over the states, counties, and cities, which the people directly use; and do they not go to the building and maintaining of the eleemosynary institutions of the states, which benefit the people directly more than in spending the money from federal taxes for large standing armies and big navies?[12]

Surtax rates adopted. The surtax rates adopted in the new law for incomes received beginning January 1, 1922, start at 1 per cent, upon the amount by which the net income exceeds $6,000 and does

[12]House Report, no. 350, 67 Cong., 1 Sess., part 2, pp. 10-11.

not exceed $10,000. With the exceptions that there is no 7 per cent or 14 per cent rate and that the 15 per cent bracket consists of the $4,000 between $32,000 and $36,000, the surtax rates increase by steps of 1 per cent upon each income bracket of $2,000 until they reach a rate of 47 per cent upon the bracket between $98,000 and $100,000. Then the brackets become much larger, the taxes being 48 per cent on the bracket $100,000 to $150,000, 49 per cent on the bracket $150,000 to $200,000 and 50 per cent on the net income in excess of $200,000.[13]

Following are some of the other more important changes under Title II.

Dividends. The new law states specifically that a stock dividend shall not be subject to tax, thus conforming to the decision of the supreme court in the case of Eisner *vs.* Macomber.[14] The same section (201) "provides a general rule for distributions in liquidation and all other distributions otherwise than out of earnings accumulated since February 28, 1913. The rule is that such distributions shall be treated as a partial or full return of cost to the distributee of his stock or shares, and if the stockholder receives more than the cost price of the stock, he is taxable under section 202 [excess of receipts over cost price] with respect to the excess in the same manner as though such stock had been sold."[15] Gains accruing prior to March 1, 1913, the approximate date when the income tax amendment became a part of the Constitution, are not to be included in taxable income when stock is sold. It is further provided that a taxable distribution shall be included in gross income as of the date when the cash or other property is unqualifiedly made subject to the demands of the distributee. In other words, such distributions are not taxable to the individual distributee as of the date earned if control is retained in the hands of the corporation until a later date.[16]

Property acquired before March 1, 1913. Because of the supreme court decisions in the cases of Goodrich *vs.* Edwards and Walsh *vs.* Brewster (decided March 28, 1921) the new law states definitely the rule for determining gain or loss in the case of property which was acquired before but sold after March 1, 1913. Prior to these decisions, the value as of March 1, 1913, regardless of original cost, was considered the basis for determining gain or loss in case of a sale.

[13]For rates applicable to the income received in 1921 and preceding calendar years see the June, 1919, issue of this REVIEW, pp. 217 and 218.

[14]252 U. S., 189.

[15]*Report of the Senate Finance Committee,* Senate Report, no. 275, 67 Cong., 1 Sess., pp. 9-10.

[16]See Senate Report, no. 275, 67 Cong., 1 Sess., pp. 9-10.

The concession of the Solicitor General in the above cases, adopted by the court, was to the effect that gain or loss in every case is to be determined upon the basis of cost or acquisition value and not by the March 1, 1913, value of the property, the gain or loss accruing before that date, however, being excluded for purposes of computing the net income subject to tax.[17]

The new law is more liberal to the taxpayer in providing that cost price or fair value as of March 1, 1913, whichever is the more favorable to the taxpayer, shall be taken as the basis for determining gain or loss except that "if the amount realized therefor is more than such basis [cost] but not more than its fair market price or value as of March 1, 1913, or less than such basis [cost] but not less than such fair market price or value, no gain shall be included in and no loss deducted from gross income."[18] An exception is the case of property which should be included in the inventory where the basis is the last inventory value.

Sale of gifts. A new rule has been made also for determining gain or loss from the sale of gifts. Heretofore the ruling of the Commissioner of Internal Revenue has made the value at the time of acquisition the basis. It is alleged that this has enabled many persons to evade taxes by giving property which has appreciated in value to wives, relatives, or others shortly before making a sale. The new rule is that the basis for determination of gain or loss in the case of property acquired by gift after December 31, 1920, shall be the same as if the property were sold by the last preceding owner by whom it was not acquired by gift. The former ruling seems to hold and to be confirmed by statute in the case of inheritances, however, the phraseology of the new law being: "In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of such acquisition."[19] This exception may be justified on the ground that such property may be subject to the inheritance tax and that there is no prima facie evidence of a donation for the purpose of evading the income tax.

Exchanges of property. The recent act makes another provision that is more favorable to the taxpayer, also, in certain cases where property is exchanged for other similar property, especially where the property received in exchange has no readily realized market value or where the conversion is more or less compulsory as, for example, in case of fire, shipwreck, or condemnation of property for public use.

Capital gain. Another change is the definition of and the special

[17]See Senate Report, no. 275, 67 Cong., 1 Sess., pp. 9-10.

[18]*Revenue act of 1921,* sec. 202 (b).

[19]*Ibid.,* sec. 202 (a) (3).

provision for the taxation of capital gain or the deduction of capital loss. During 1921 the United States District Court of Connecticut[20] ruled that an appreciation in capital assets, inasmuch as it was merely an increase in capital rather than income, was not taxable as income under the federal income tax amendment. This decision was in conformity with British practice and some American economists supported it but, if it had been upheld, the administration of the income tax would have been thrown into utter chaos. No one knows how many millions of back taxes that had already been paid and spent would have been thrown into litigation. The effect upon government finances and credit might have been exceedingly serious. But the supreme court soon reversed the decision of the Connecticut court,[21] rightly in the opinion of the writer, and the Revenue act of 1921 definitely recognizes and defines the difference between "capital gain" and "ordinary net income" from the latter of which all items of capital gain, capital loss, and capital deductions are excluded.

The ruling of the Commissioner of Internal Revenue has been that a gain such as is now termed a capital gain should be taxable in its entirety as of the date when the sale is made, although the property might have been held and the actual gain might have accrued gradually through a number of years. If the payment in case of sale was a relatively small one, that is, not substantial enough to assure a closed transaction—for example, if it was less than 25 per cent of the total price, the gain might be apportioned over the various years in which installment payments were made. It is obvious that if a sale was made in a year in which tax rates were very high, especially if the seller had a large income which subjected him to the higher surtax rates, a large part, (possibly as much as 73 per cent or more) of the entire increase between cost and selling price might be taken in one year's tax, even though much of the gain might be nominal rather than real because of differences in the purchasing power of money. As a consequence many sales have been held up, business has been hindered, and the government has failed to get taxes where substantial revenue might have been obtained if the rates had been lower.

To remedy this situation in part, the new law provides that capital net gains of individuals may be taxed at 12½ per cent instead of at the higher surtax rates which are applicable to ordinary net incomes that reach the higher brackets, provided that any one who elects to have his capital gains taxed at 12½ per cent shall in no case pay less than 12½ per cent upon his entire net income. In other words, this limitation on the taxation of capital gains is of benefit to no

[20] *Walsh* vs. *Brewster,* 268 Fed. 207.

[21] *Supreme Court Reporter,* vol. 41, no. 13, p. 392, (May 1, 1921.)

individual having a net income of less than $31,000, for such a person would have to pay less than an average of 12½ per cent any way. The Senate bill provided that only 40 per cent of capital gains should be taxed. This would have been of advantage to people of small means as well as to those with large incomes but this provision was defeated in conference and the provision stated above substituted. Senator Jones of New Mexico, whom few would characterize as one of the radical Democrats of intemperate speech, said of the conferees' change: "Can Senators imagine a more stupendous infamy than such a proposition as that? At the time the conferees of the Senate were appointed, the Senate wanted all to participate alike in the reduction of taxation upon capital gain; but as I think the Senate and the country will believe the conferees carried out the purpose to grant relief through this bill only to those who are profiteering upon the country, who have high incomes, and to put the burden upon those who are less able to pay."[22] Apparently the law does nothing to modify the ruling which allots for tax purposes all of the capital gain to the year realized upon, regardless of when or how long it was accruing.

Deductions and exemptions. In the main, the new law allows the same deductions from gross income to arrive at taxable net income as did the previous law. A minor exception is in the case of traveling expenses where the taxpayer may deduct the entire amount expended for meals and lodging while away from home in the pursuit of a trade or business. Only a part of such living expenses was deductible under the ruling of the Commissioner prior to the passage of the present law.

Building and loan association dividends. Another deduction permissible for individuals for each of the five years beginning January 1, 1922, is that of $300 of interest or dividends received from domestic building and loan associations operated exclusively for the purpose of making loans to members. This provision was severely criticised as a discrimination in favor of investments in building and loan associations and against investments in Liberty bonds, savings deposits, etc. The House bill had proposed an exemption of $500 a year in such cases. Commenting upon the exemption of the smaller amount, Senator Smoot, one of the conference managers for the Senate, said: "I think it is an outrage. It is unjust. It cannot be defended, in my opinion; but we had to yield [to the House conferees] or have no report. This is what it means: Six per cent on $5000 is $300. Therefore, if a man and his wife and six children want to invest $5000

[22] *Cong. Record,* Nov. 23, 1921, p. 9071.

each in these associations, they can have an exemption of the income from $40,000."[23]

Income of building and loan asociations. The above has reference to parts of individual incomes received from building and loan associations. In the part of the law that deals with taxes on corporations, domestic building and loan associations are exempt from the corporation income tax if substantially all of their business is confined to making loans to members. The rather general exemption of building and loan associations under previous income tax laws has led to much complaint on the part of savings banks and others, especially in Ohio and surrounding states where such associations carry on more or less of what is usually considered banking business. The new law attempts to remove this discrimination which was more or less difficult to handle by mere rulings of the Commissioner of Internal Revenue.

Annual net losses carried forward. A much more important provision of the new law than those allowing increased deductions in connection with traveling expenses and building and loan association dividends is that which allows the net losses of a business incurred in one year to be deducted from the taxable net income of the following year or years, effective beginning January 1, 1921. There was a provision somewhat like this in the act of 1918 for any taxable year beginning after October 31, 1918, and ending prior to January 31, 1920, which was meant to take care of the extraordinary inventory and similar losses which were expected to result from the post-war adjustments. But the general rule heretofore has been to consider the income of one year as a unit by itself, entirely unrelated to the income of other years for tax purposes. Over a term of years the net losses of an individual or of a business concern might exceed the total of net gains for the more prosperous years; nevertheless, under most former laws, taxes would have to be paid upon the incomes of the prosperous years. This practice is evidently a discrimination against businesses and individuals with fluctuating incomes as compared with those having equivalent but regular incomes from year to year. The British have met this situation in part by using as a base for tax purposes the average income of the last three years instead of one year only. The change in the act of 1921 is a real improvement because the chopping of income into units of a year is purely arbitrary and merely for convenience. There does not seem to be sufficient reason, however, for confining this provision to losses resulting from the operation of trade or business regularly carried on by the taxpayer. It should apply to all losses where the corresponding gain is taxable. The same might be said of the new provision which prohibits the deduction of losses in case of

[23]*Cong. Record,* Nov. 23, 1921, p. 9066.

"wash sales," that is, where stocks are sold to establish losses for income tax purposes and are then repurchased within thirty days.

Liberty bond interest. In concluding the comments upon changes and proposed changes in deductions and exemptions under the new law it might be mentioned that the Senate Finance Committee eliminated from the House bill the provision exempting from the income tax the salaries of the President and federal judges;[24] also, that a slight amendment has been made for the purpose of simplifying the very complex exemption privileges accorded to interest on Liberty bonds under the various Liberty Loan and Revenue acts.

Returns. A new requirement is that a return, or statement of income, must be made by "every individual having a gross income for the taxable year, of $5000 or over, regardless of the amount of his net income." This requirement applies also if the aggregate income of husband and wife is $5000 or over. The provision of the former law, which is included in the new law, is that a return shall be made by every unmarried individual and, also, by every married individual who does not live with husband or wife, whose net income for the taxable year is $1000 or over, and by heads of families whose income is $2000 or over. Where the aggregate net income of husband and wife is $2000 or over, or where the aggregate gross income is $5000 or over, each may make a separate return or they may make one combined return. In practice, if the aggregate is large enough to be subject to surtax rates, two returns are likely to be made in order that all or a part of the surtaxes may be evaded.

Title II—Income tax—Corporations.

Title III—War-profits and excess-profits tax for 1921. The income tax on corporations which is a part of Title II and the excess-profits tax which applies to corporations only and which forms Title III can be most profitably discussed together for the reason that the principal change in the former is made in lieu of the change in the latter. In other words, the corporation income tax is increased from 10 per cent to 12½ per cent in lieu of the repeal of the excess-profits tax, both changes applicable to income received after December 31, 1921.

It will be recalled that the Revenue act of 1918 was practically framed before the signing of the Armistice on November 11, 1918, though a number of changes were incorporated after that date and before the final approval on February 24, 1919. On May 20, 1919, soon after his return from the Paris Peace Conference and only three months after the Revenue act of 1918 became law, President Wilson in his message to Congress urged the early revision of the tax laws

[24]*Commercial and Financial Chronicle,* Sept. 1921, p. 1207.

and mentioned in particular that excess-profits tax rates which were appropriate for war years were not appropriate for a permanent peace time system. He was not in favor of repealing the excess-profits tax, however, saying: "I take it for granted that its [our tax system's] mainstays will henceforth be the income tax, the excess-profits tax, and the estate tax." In his annual message of December 7, 1920, he again urged "immediate consideration of the revision of our tax laws. Simplification of income and profits taxes has become an immediate necessity." At least nine months before this latter date, his Secretary of the Treasury, Mr. Houston, suggested to Chairman Fordney the "fundamental modification or repeal of the excess-profits tax at the earliest possible future date."[25]

Professor T. S. Adams has been the principal treasury expert and adviser of Secretaries of the Treasury, Ways and Means Committees, and Finance Committees on matters of revenue legislation not only during the previous Democratic administration of eight years but also during the present administration to date. Before the American Economic Association, Professor Adams had previously discussed the excess-profits tax as a new important and permanent source of revenue, but by 1920 or before he was evidently convinced that it should be repealed—chiefly because it worked unequally as between different business organizations and because its administration clogged the internal revenue machinery and indeed threatened its breakdown.[26] That Professor Adams' influence has been remarkable is evidenced by the recommendations both of President Wilson's Secretaries of the Treasury and also of President Harding's Secretary as well as by the bill of the Ways and Means Committee and also the bill of the Finance Committee, and this is especially noteworthy in view of the overwhelming political revolution following the somewhat bitter election campaign of 1920. Not all of these recommendations and bills have conformed exactly to Professor Adams' published articles but the internal evidence of his influence is strong in each case.

It will be recalled that the Revenue act of 1918 provided for a corporation tax of 10 per cent upon net income, after an exemption of $2000, in addition to the excess-profits tax. The excess-profits tax exempted $3000 plus 8 per cent upon invested capital and then took one fifth of the net income in the bracket between the exemption and a profit of 20 per cent on invested capital, and two fifths of profits in excess of 20 per cent. In arguing for the repeal of the excess-profits

[25]*Annual Report for 1920,* p. 32.

[26]*Needed Tax Reform in the United States,* a series of ten articles published in the *New York Evening Post* in the summer of 1920 and later reprinted in pamphlet form, is one of the most informing brief discussions that has been published.

tax, Professor Adams had suggested as a partial substitute a tax of 20 per cent upon the undistributed earnings of corporations and also upon other investments or savings. In conformity with his suggestion, Secretary Houston in a letter of March 17, 1920, to Chairman Fordney and again in his *Annual Report for 1920* recommended a 20 per cent rate upon corporate net income, but suggested also the possible desirability of 25 per cent for the first fiscal year, 20 per cent the second and 15 per cent thereafter. It has been noted above that Secretary Mellon recommended that the corporation income tax rate be increased 5 per cent, thereby making it 15 per cent instead of 10 per cent. The House, however, put the rate at 12½ per cent. Chairman Fordney estimated that the repeal of the excess-profits tax would reduce revenues by $450,000,000 but that the increase of the corporation tax by 2½ per cent would make up for $133,750,000 of the loss.

Repeal of excess-profits tax. The Senate Finance Committee recommended a 15 per cent corporation tax but the repeal of the capital stock tax of $1 per $1000 of capital. In recommending the repeal of the excess-profits tax, it assumed that everyone was convinced of the desirability of such a change because "whatever may be its theoretical merits, in practice it exempts the overcapitalized corporation, falls more heavily upon corporations of small or moderate size than upon larger corporations, penalizes business conservatism, and places upon the Bureau of Internal Revenue tasks beyond its strength." In confirmation of this statement the committee presented the following table based upon the latest Treasury statistics covering all corporations which made full returns of invested capital:

TABLE A.—AVERAGE RATE OF EXCESS-PROFITS AND INCOME TAXES UPON CORPORATIONS OF DIFFERENT SIZES.[1]

(Average size of corporations—measured by invested capital—earning different rates of profit; corporation returns made in 1919.)

Per cent of net income to invested capital	Number of corporations	Invested capital	Average invested capital	Per cent income and profits tax to net income
Less than 5	10,689	$14,104,248,246	$1,319,511	10.99
5 to 10	21,869	15,925,632,944	729,229	11.93
10 15	22,684	8,962,689,034	395,111	21.60
15 20	17,388	5,482,627,463	315,311	33.99
20 25	11,987	3,251,948,260	271,290	41.51
25 30	7,743	3,785,581,785	488,904	51.22
30 40	9,050	2,421,285,621	267,545	53.38
40 50	4,807	1,232,173,122	256,329	57.58
50 75	4,911	784,254,745	159,693	62.30
75 100	1,734	205,744,478	118,653	64.24
100 and over	2,194	133,853,470	61,009	67.40
Total	115,056	$56,290,039,168	$489,240	37.86

[1]Senate Report no. 275, 67 Cong., 1 Sess., p. 4.

The recommendations of the majority of the Ways and Means Committee and also those of the majority of the Finance Committee were violently attacked by the opposition. In his minority report Mr. Kitchin stated:

An analysis of the statistics contained in the detailed report as to corporation incomes and income and excess-profits taxes in the report of the commissioner for the calendar years 1917 and 1918—the 1918 report being the first and only one containing the details of corporate income and income and excess-profits taxes arranged in classes according to the amount of profits each class made—shows *that 180 corporations making annually from $5,000,000 up to $300,000,000 and over* (the Steel Corporation made over $500,000,000 net profits in 1918) had a net income of $2,554,000,000, and while paying only $203,000,000 income tax paid $848,000,000 excess-profits taxes, while the over 300,000 corporations making from nothing up to $100,000 net income yearly paid only $285,000,000 excess-profits taxes.

One thousand and twenty-six corporations, with a net income of $4,255,-000,000, more than one half of the total corporate net income of all the 317,559 corporations, while paying only $333,000,000 income tax, paid $1,422,000,000 of excess-profits tax; that is, paid over one half, or nearly two thirds, of the entire excess-profits tax, and $344,000,000 excess-profits tax more than the remaining 316,500 other corporations.

An analysis of the returns as detailed in the reports of the Commissioner of Internal Revenue since January 1, 1916, up to and including the present commissioner's report of July 12, 1921, will show that corporations in the United States made net profits to January 1, 1921, in round numbers $50,000,000,000—to be more exact, $47,000,000,000. *After deducting all the taxes* they paid since January 1, 1916, income, excess-profits tax, and other war taxes, *they have a clear profit left of $38,000,000,000, more than four fifths of which was made by less than 10,000 corporations, and more than half of which was made by 1,026 of the big profiteering corporations,* which includes the Steel Trust, the Bethlehem Steel Co., the Dupont companies, the various Standard Oil Companies, the coal combine, the woolen trust, the meat packers, etc.

I trust no Democrat will join with the Republicans in this monstrous scheme. The 12½ per cent flat tax on corporations, even retaining the present exemption of $2,000, *will increase the tax of the smaller and weaker corporations* (which number about 250,000) making 6, 7, and 8 and 10 per cent on invested capital *at least 50 per cent* and *decrease the taxes of these big profiteering corporations from 33 1-3 to over 50 per cent* which make 20, 30, 40, and 50 per cent, and over, on invested capital, which corporations number less than 10,000.[27]

Many others in both House and Senate made statements of similar tenor.

The motion of Senator Reed of Missouri to retain the excess-profits tax was rejected by a vote of 39 to 28, 24 Democrats and 4 Republicans

[27]House report, no. 350, 67 Cong., 1 Sess., part 2, pp. 2-4.

voting for it. The Senate next rejected a motion to retain the tax at about half the former rates. On October 26, the Senate voted to repeal this tax upon income received after December 31, 1921, instead of making it effective on the income received in 1921 as favored by the leaders of the Finance Committee and many others. All Democrats and six Republicans voted against this repeal. Senator Reed then proposed that there be an excess-profits tax of 20 per cent on the bracket of profits between 15 per cent and 50 per cent and a 40 per cent tax on profits over 50 per cent. This was rejected, 42 to 31, whereupon he proposed a tax of 20 per cent upon profits in excess of 50 per cent. This was rejected 42 to 33, eight Republicans voting for it.[28] About the time the American Legion was in session at Kansas City, Senator Reed sustained his reputation as gadfly of the Senate by proposing to retain the excess-profits tax in order to finance a soldiers' bonus. This probably caused some senators uneasiness about their records but was rejected, 39 to 28.

Corporation tax rate. The rate of the corporation tax was more in doubt when Congress began revenue revision than that the excess-profits tax would be repealed. Senator Jones of New Mexico proposed that instead of a 15 per cent flat rate there should be a graduated tax on the undistributed profits of corporations, 8 per cent on the first 10 per cent of net income with rates gradually increasing up to 56 per cent on amounts of income over 60 per cent. This was rejected, 45 to 24, four Middle Western Republicans voting for it and three Democrats opposing it. Then Senator Simmons proposed that in addition to a flat tax of 15 per cent, there should be a graduated tax averaging about 9 per cent on the undistributed profits of corporations which he estimated would yield about $60,000,000. Senator Walsh, Democrat of Massachusetts, proposed a graduated tax of

10 per cent on the first $100,000 of corporate net income
15 " " " " next 200,000 " " " "
20 " " " all over 300,000 " " " "

This and another somewhat similar amendment were rejected by very close votes, 33 to 32 in the first case. Such a provision would not have required the determination of invested capital which was one of the greatest difficulties under the act of 1918.[29]

A more or less general sales tax was another substitute that was proposed in lieu of excess-profits tax instead of increased corporation income taxes. This proposal had the support of an immense propaganda in the press of the country; in fact, this propaganda appears to have almost unlimited financial backing. Secretary Mellon in his letter

[28] *Commercial and Financial Chronicle,* Oct. 29, 1921, p. 1837.
[29] *Commercial and Financial Chronicle,* Nov. 5, 1921, p. 1937.

of April 30, 1921 to Chairman Fordney stated that he was not prepared to advocate a sales tax, but, shortly before the Finance Committee took up the consideration of the bill, Senator Smoot proposed a manufacturers' sales tax of 3 per cent. This was not something new; in 1918 he had proposed a one per cent sales tax upon consumption goods which he estimated would raise practically our entire revenue. In his proposal of last August the sales tax was not to take a rôle quite so important and exclusive as in his previous proposal, but even in this case it was to be the largest of his six sources of taxation. His plan, which would so simplify our complex revenue laws that "anybody can make out his tax return," which would "do away with about two thirds of the employees in the revenue service" and thus result in a saving of perhaps $25,000,000, was as follows:[30]

Income taxes (maximum rate 32 per cent)	$830,000,000
10 per cent on net corporation profits	445,000,000
Tobacco taxes (present rates)	225,000,000
Estate taxes	150,000,000
Import taxes (tariff)	400,000,000
Manufacturers' sales tax (3 per cent)	1,200,000,000
Collection of unpaid taxes, salvage, etc.	615,000,000
	$3,895,000,000

Senator Moses in urging the adoption of the Smoot manufacturers' sales tax said that it would "strike down the vicious principle of graduated taxation which appears in the pending tax bill, and which is but a modern legislative adaptation of the Communistic doctrine of Karl Marx."[31]

This proposal met so much opposition, especially from the agricultural bloc, that Senator Smoot reduced the rate from 3 per cent to 1 per cent. This was rejected November 3 by a vote of 43 to 25, all voting in favor being Republicans while the opposition was made up of 17 Republicans and 26 Democrats. The next day Senator Smoot's substitute of a business sales tax of one half of one per cent on gross sales exceeding $6000 a year was rejected by a vote of 46 to 25. This time the Democrats in opposition were joined by 22 Republicans. "According to Washington press dispatches this was regarded as ending the effort to include a sales tax provision in the pending revenue measure."[32] In what was termed Senator Smoot's "final plea" for the adoption of his amendment he said that three fourths of the people of the United States were in favor of the sales tax. This state-

[30] *Commercial and Financial Chronicle,* Sept. 3, 1921, p. 1005; and Oct. 8, 1921, p. 1529.

[31] *Ibid.,* Oct. 22, 1921, p. 1728.

[32] *Commercial and Financial Chronicle,* Nov. 5, 1921, p. 1937.

ment was challenged by Senator Lenroot of Wisconsin who declared that the farmers and organized labor were against it and that the manufacturers would be against it when once they understood the proposition. He forecasted and later Chairman Fordney confirmed his statement that a sales tax would be introduced during the regular session of Congress as a means of financing a soldiers' bonus.[33]

But those who thought the sales tax was dead did not know Senator Smoot very well. "At Monday's session of the Senate (November 7) which was extended to the early morning hours of the 8th, Senator Smoot again brought up his sales tax plan, this time offering his original proposal calling for a 3 per cent manufacturers' levy, with a 10 per cent corporation tax, a 32 per cent maximum income tax and a capital stock tax."[34] Earlier he had argued that since a sales tax was to be adopted in connection with the soldiers' bonus, he thought it would be wise to put it into effect now in order to determine the rate that would be necessary to yield the money needed. This last proposal was rejected without a record vote.

Shortly after the rejection of this midnight proposal (at 1:35 a. m. November 8) the Senate passed its revenue bill which was then sent to conference. In lieu of the repeal of the excess-profits tax it agreed to raise the corporation income tax from 10 per cent to 15 per cent, both changes effective on income received after Dec. 31, 1921. In the conference, however, the Senate managers receded and accepted the House bill rate of 12½ per cent though the House conferees accepted the Senate proposal to withdraw the specific exemption of $2000 in case of corporations having net incomes in excess of $25,000. Senator Jones in criticizing this action said that there was no reason why the wealthy could not now incorporate and never pay more than a 12½ per cent tax, though in introducing the bill Senator Penrose made a special point in his report that it provided that, if any corporation is formed or availed of for the purpose of evading the surtax upon its stockholders by permitting profits to accumulate instead of being distributed, the stockholders shall be taxed in the same manner as partners.[35] The administration of such a provision is obviously very uncertain and difficult.

Though the new law follows the old law substantially in most other matters relating to corporations, there are a few other changes and proposed changes that will be mentioned.

Foreign traders. The Senate Finance Committee retained the proposal of the House bill to tax American "foreign traders" and "foreign

[33] *Ibid.,* Nov. 5, 1921, p. 1937.
[34] *Ibid.,* Nov. 12, 1921, p. 2037.
[35] See Senate Report, no. 275, 67 Cong., 1 Sess., p. 16.

trade corporations" only on income derived from sources within the United States. Both the Ways and Means Committee and the Finance Committee explained in their reports that the income of such traders was taxed both at home and abroad and that this resulted not only in unjust double taxation but also in inability to compete with foreign traders of other countries in China and elsewhere. This proposal provoked a contest on the floor of the Senate. Senator Simmons claimed that the suggestion came from sources "profoundly interested in advancing the interests of consolidated, coördinated, combined and predatory wealth .... and it would have been nothing more or less than a present out of the Treasury of the United States to that class of great, powerful people who control our foreign commerce, sell our exports abroad, and buy our imports abroad, to say nothing of the great international banks of the country, of something near $300,000,000."[36] The provision was defeated by a narrow majority of the Senate but when it got to conference the Senate's action would have been overturned, according to Senator Simmons, had not he and Senator La Follette made a strenuous fight to prevent "the slaughter which had been prepared for it."[37]

Life insurance companies. The new law modifies the provisions of the former law with reference to taxes on life insurance companies. There has been much litigation under the previous law and it is claimed that the taxes which these companies paid are inadequate. The new law provides that for 1921 and thereafter they shall be taxed upon their investment income from interest, dividends, and rents much the same as are other corporations upon their net income received after December 31, 1921, except that the life insurance companies are relieved of the capital stock tax.[38]

Partnerships and personal service corporations. As in previous laws, partnerships are not taxed as corporations but each of the partners is taxed under the individual income tax sections of the law. Personal service corporations, that is, those whose income is derived chiefly from the services of the chief stockholders, or where the income derived from invested capital is not a material part of the total, were, under the previous law, treated as partnerships instead of being taxed as corporations. The new law continues this arrangement for income received prior to January 1, 1922, after which these corporations are to be taxed like other corporations. If, however, partnerships or individuals in business prefer to be taxed as corporations for 1921

[36]*Cong. Record,* Nov. 23, 1921, pp. 8994, 8995.

[37]*Cong. Record,* Nov. 23, 1921, pp. 8994, 8995.

[38]House Report, no. 350, 67 Cong., 1 Sess., p. 14, and *Revenue act of 1921,* sec. 242ff.

and succeeding calendar years rather than as individuals, they may be so taxed, provided they incorporate within four months after the passage of the act, that is, prior to March 23, 1922; provided further, that the taxable net income for 1921 was not less than 20 per cent of the invested capital; and, provided further, that the capital stock tax of $1 per $1000 of invested capital is also paid. This provision removes one of the weightiest criticisms of the act of 1918 because under that act the amount of the tax payable often depended very much upon the form of the organization as well as upon the amount of profits. Secretary Houston in his letter of March 17, 1920, to Chairman Fordney of the Ways and Means Committee, mentioned as one illustration of the necessity of revision of the act of 1918 a well-known partnership which paid in 1918 nearly $1,125,000 more taxes than it would have paid had the business been organized as a corporation. On the other hand corporations have frequently paid more than if they had been organized as partnerships.[39]

Publicity of returns. One contest that developed some heat was over the publicity of returns. All previous income tax laws from 1913 on have provided that returns shall be open to inspection only upon the order of the President, though provision was made for the officers of states having a state income tax to inspect corporation returns and for stockholders to examine annual income returns of the corporations in which they, as stockholders of record, own 1 per cent or more of the outstanding capital stock. Senator La Follette made at least two attempts to make returns open to public inspection and the vote in one case was rather close, 35 to 33. Senator Reed proposed that returns should be open "at the request of either House of Congress." The Senate adopted this amendment but it was struck out in conference. Few acts of the conferees were subject to more scathing criticism than was this.[40]

Title IV—Estate tax. The rates of the federal estate tax are not changed by the act of 1921, despite a spirited contest in the Senate which led to a night session and the doubling of the maximum rates on the larger estates by a Senate vote of 44 to 15. It will be recalled that the act of 1918 exempts the first $50,000 in order to arrive at the taxable "net estate" and then begins with a tax of 1 per cent on the next $50,000. The rate increases until it reaches 25 per cent on the part of a taxable "net estate" in excess of $10,000,000. The

[39]See *Annual Report of the Secretary of the Treasury for 1920,* p. 32.

[40]*Cong. Record,* Nov. 22, 1921, pp. 8996 and 8997, and Nov. 23, 1921, p. 9059.

Senate bill did not change these rates except those on "net estates" in excess of $15,000,000, as follows:

"Net estates" (in millions of dollars)	Rate of tax proposed. Per cent
15—25	30
25—50	35
50—100	40
100—more	50

The Senate also adopted by a vote of 31 to 35 an amendment of Senator Walsh of Massachusetts to tax gifts at the same rates at which "net estates" are taxed under both 1918 and 1921 acts, except that no deduction of $50,000 was allowed and the one per cent tax began on gifts in excess of $20,000. A new schedule of estate tax rates reaching a maximum of 50 per cent on estates in excess of $30,000,000 was proposed by Senator La Follette. This was rejected, as were his and Senator Kenyon's proposals to tax at 10 per cent and 15 per cent respectively the transfer of certain tax-exempt securities forming parts of estates. Senator Kenyon proposed that his amendment apply only to securities issued six months after the passage of the act and it was barely rejected, the vote being a tie, 32 to 32.

Senator Penrose reported that the Senate conferees yielded "to the persuasive arguments and persistent demands of the House conferees" on the Senate amendments, both as regards the higher rates on estates and also as regards any tax on gifts. He stated that the proposed increased rates would not bring any additional revenue before the fiscal year 1924, that they would cause the distribution of estates before death in order to escape the tax and, furthermore, that some states already have inheritance taxes exceeding 25 per cent. The rejection of the higher estate taxes by the conferees was then given as a reason for the rejection of the tax on gifts. These concessions on the part of the Senate conferees were attacked as inconsistent and as a surrender to wealth by Senator Jones of New Mexico and others.[41] Neither the House nor Senate changed these or any other provisions agreed to by the conference.

A new administrative provision of this title permits an executor or administrator to file application for discharge from personal liability for any estate tax not assessed within one year after the filing of the application, but such discharge does not release the estate from the lien of any tax. Under the previous law executors have been held personally liable for estate taxes assessed long after the closing of

[41] *Commercial & Financial Chronicle,* Nov. 5, 1921, p. 1937; Nov. 12, p. 2037; *Cong. Record,* Nov. 22 and 23, pp. 8992 and 9072.

estates.[42] An attempt has been made in the new law also to prevent discrimination in taxing the estates of missionaries merely because they reside in foreign countries.

Title V—Tax on telegraph and telephone messages. (*Transportation tax omitted.*) The most significant change in this title is the omission of the tax on transportation. It will be recalled that under the Revenue act of 1918 amounts paid for freight were taxed 3 per cent, amounts paid for express shipments 1 cent for each 20 cents or fraction thereof, amounts paid for passenger and Pullman tickets 8 per cent, and amounts paid for transportation of oil by pipe line also 8 per cent.

It has been noted above that Secretary Mellon at first opposed the removal of the tax on transportation unless Congress could find a suitable substitute because he said it yielded about $330,000,000 a year in revenue. The Administration later seemed inclined to do all it could for the railroads on the theory that the revival of their finances and facilities was the key to general economic improvement. Consequently, after the conference of Administration leaders on August 9, Secretary Mellon advocated repeal of half the transportation taxes January 1, 1922, and the other half a year later. The Senate accepted this recommendation but the conferees accepted the House provision to repeal transportation taxes, effective January 1, 1922. Mr. Fordney estimated that this action would cause a loss in revenue of $262,000,000.

This title retains the tax of 5 cents upon telephone, telegraph, cable and radio messages upon which the charge is 15 to 50 cents and 10 cents where the charge is greater, as well as the tax of 10 per cent on the amounts paid for leased wires but it omits the provisions relative to the taxes on insurance.

Title VI—Tax on beverages. This title has to do not only with soft drinks but also with alcoholic liquors diverted to beverage purposes or for use in manufacture. In order to aid in the enforcement of the law the Treasury Department suggested and the Senate bill provided for doubling the tax on liquors diverted to unlawful purposes. It also provided for the concentration of liquors in fewer government warehouses. Senator Willis, Republican of Ohio, charged that, in the bill as adopted by the conferees and as later enacted into law, the "conferees have agreed absolutely to wipe out the amendments that were written by the Senate and to adopt the House provision." Senator Smoot explained that the Senate conferees were forced to accede to the House conferees because the latter "did not want to tax whiskey sold by a drug store as a beverage, because they designated it

[42]House Report no. 350, 67 Cong., 1 Sess., p. 15.

as medicine."[43] As the law stands, it provides for a tax of $2.20 per gallon upon spirits in bond or upon those produced in or imported into the United States, and $4.20 additional if diverted to beverage purposes or for use in manufacture.

Light manufacturers' taxes are imposed upon sirups and carbonated gas used in the production of soda fountain drinks and similar preparations in lieu of the so-called "nuisance taxes" levied by the former law upon soda fountain drinks, ice cream, sundaes, etc. The old taxes were difficult to administer and it was estimated that dealers held back from the government 30 per cent of the amounts due. Chairman Fordney estimated that the change in the House bill meant a yearly loss of $24,000,000, but he counted on $10,000,000 from a license tax of $10 on each seller of soft drinks, a provision eliminated by the Senate.

Title VII—Taxes on cigars, tobacco, and manufactures thereof. This title of the old law is reënacted substantially without change.

Title VIII—Tax on admissions and dues, is also substantially a reënactment of the corresponding title in the former law except that under the new law the exemption from the tax is extended to a larger class of benefit performances and, furthermore, no tax is collected from persons admitted free and those admitted at reduced rates are taxed on the basis of the amount paid.

Title IX—Excise taxes. The new law takes the tax off of some sporting goods, chewing gum, cosmetics, proprietary medicines and some other goods; reduces the tax on candy from 5 to 3 cents per pound and in general cuts the tax from 10 per cent to 5 per cent on the excess price of expensive carpets, clothing, lighting fixtures, etc., besides eliminating some articles and changing the basis for others. The most renumerative taxes, are retained, namely, those on automobiles, motorcycles, tires, and accessories. Many inconsistencies appear in this title, for example, why should candy be taxed and chewing gum be exempted, or cameras be taxed and billiard balls be exempted, or automatic slot-device vending machines be taxed 5 per cent while automatic slot-device weighing machines are taxed 10 per cent. Professor Adams and Senator Smoot have pointed out not only these but other inconsistencies. In a title which deals with such a miscellany as does this, only typical cases can be mentioned here.

Title X—Special taxes on miscellaneous occupations, tobacco manufacturers, narcotics, etc., has not been greatly changed. The first section of this title provides for the same capital stock tax as that in the former law, namely, $1 for each $1000 of the fair average value

[43] *Cong. Record,* Nov. 23, 1921, pp. 9067 and 9068.

of capital stock in excess of $5000. The Ways and Means Committee proposed a limitation of fifteen months for the assessment of this tax, and the Finance Committee proposed to eliminate it entirely, but the Senate restored it after a contest and it was retained by the conference.

Title XI—Stamp taxes, and Title XII—Tax on employment of child labor,[44] are substantially reënactments of corresponding titles.

Title XIII—General administrative provisions. At least one change of much importance is provided for under this title.

Final determination. One of the most serious indictments against the excess-profits tax of 1918, though not the one commonly emphasized, is the clogging of the administration of all income and profits taxes because of the difficulty of determining invested capital upon which these taxes depend. The Bureau of Internal Revenue has had its burdens increased enormously by tax laws of recent years, and, in spite of the great expansion of its staff, it has not been able to keep up with its work. Part of this is due to the fact that it has a rapid turnover of personnel because many of those whom it has trained have resigned for much more lucrative positions in private practice. Furthermore, whenever a court decision or a ruling of the Commissioner reversed some former ruling, thousands of cases that were supposed to have been settled were reopened and the process of settlements was then begun all over again. As a result no one has known when any assessment was finally settled and the Bureau has fallen almost hopelessly behind with its work. The new law makes provision for the final determination of tax cases by agreement between the taxpayer and the Commissioner so that they will not be reopened by later rulings except upon showing of fraud, malfeasance or misrepresentation materially affecting the case. This change may work some injustice but doubtless it will lessen much injustice, also. That it is really one of the major changes brought about by the new law may be indicated by the accompanying tables which show how far the Bureau of Internal Revenue got behind with the administration of the taxes.

[44]The question of the constitutionality of this title of the former law is now before the Supreme Court.

STATEMENT OF CONDITION OF WORK, INCOME-TAX UNIT, AUG. 31, 1921.[1]

	Total returns filed or to be handled	Total returns audited		Balance to be audited	
		Number	Per cent	Number	Per cent
Personal:[2]					
1917	830,000	827,702	99.7	2,298	0.3
1918	660,000	627,227	95.0	32,773	5.0
1919	850,000	285,953	34.0	564,047	66.0
1920	890,000	168		889,832	100.0
Total	3,230,000	1,741,050	54.0	1,488,950	46.0
Corporation:					
1917	323,138	305,417	94.5	17,721	5.5
1918	368,290	278,323	75.6	89,967	24.4
1919	368,222	133,351	36.2	234,971	63.8
1920	349,500	2,734	.8	346,766	99.2
Total	1,409,250	719,825	51.1	689,425	48.9

[2]The personal returns do not include the smaller returns which are handled largely in the collectors' offices. Many of the returns shown as "to be audited" were in various stages of progress.

CLAIMS PENDING, OCT. 21, 1921.[1]

	Number	Amount
Abatement of taxes assessed but not paid.........	27,519	$615,181,744
Credit claimed on account of alleged previous overpayments............................	26,146	148,097,506
Refund of taxes paid..........................	79,612	253,689,606
Total................................	163,277	1,006,968,856

[1]*Annual Report of the Secretary of the Treasury for 1921,* pp. 27, 28.

Tax Simplification Board. This title provides also for a Tax Simplification Board to consist of three members to represent the public and to be appointed by the President and three officers or employees of the Bureau of Internal Revenue. They are to investigate the procedure of, and the forms used by, the Bureau and make recommendations for simplification. The members of the board are to serve without pay and the board is to cease to exist December 31, 1924.

Unnecessary investigations. One section of this title attempts to meet the complaints of taxpayers relative to unnecessarily frequent examinations and investigations by revenue agents by prohibiting more than one inspection of the taxpayer's books a year, except by special written order of the Commissioner of Internal Revenue.

Mention has been made elsewhere of other administrative changes, for example, of those relative to the consolidation of Liberty bond tax exemptions, the requirement of returns from all having gross incomes of $5000 or over, regardless of the amount of net income, and the relief from personal liability granted executors of estates under certain conditions.

Title XV—General provisions, contains a miscellany of sections technically repealing the titles of the former law, increasing the Victory note authorization from $7,000,000,000 to $7,500,000,000 as an aggregate that may be outstanding at any one time, and increasing the Treasury Savings Certificate limit so that an individual may purchase $5,000 instead of only $1,000 of such securities in a year. The new issues of these securities bear about 4½ per cent interest and are exempt from taxation, hence, persons with large incomes are not permitted to buy them in unlimited amounts.

Comments and Conclusions

Except as noted in the opening paragraph of this article, the Revenue act of 1921 does not change greatly the Revenue act of 1918. It is a distinct disappointment to the chiefs of the party which controls overwhelmingly both houses of Congress, as well as the other branches of the federal government, especially in that it does not lower substantially the high surtax rates upon individual incomes. This is due to the influence exerted by agricultural and labor interests upon a sufficient number of Republican senators to force compromises upon the leaders, though the latter succeeded in nullifying several such compromises in the joint conference of Senate and House representatives. The leaders were successful, however, in repealing the much abominated excess-profits tax, in reducing the tax on capital gains of those having net incomes in excess of $31,000, in providing for offsetting net losses of one year against net gains of following years, in providing for the final settlement of tax cases, and in making numerous other changes of more or less significance.

Though income and profits taxes will not hereafter hold the same relative importance among federal revenues that they have held during the past few years, they still remain the mainstay of the system. The tariff has been raised, it is true, but there is no prospect that consumption taxes will again form practically the entire source of federal receipts as they did prior to 1913. The sixteenth amendment is only one reason for this; another very important one is that the needs of the government are now so much greater than they were before the war that such revenues are entirely inadequate unless we shall adopt

some general sales tax such as one of the proposals of Senator Smoot. Many business interests apparently favor such taxes and sometimes the propaganda for them seems about as strong as that for the repeal of the excess-profits tax, but the opposition from the laboring classes and the farmers will probably be more active and effective in this case than it was for the retention of the profits tax. It is possible, however, that the soldiers' bonus can be used to overcome this opposition, in fact, there is no telling in what various ways, and for how many purposes, the proposed bonus is to be used as stalking horse. Beer, as well as a sales tax, has already been proposed.[45]

Despite the fact that few changes have been made in the new revenue law, some of them are notable improvements. That providing for final settlement of tax cases by agreement between the taxpayer and the Commissioner has been recommended by the Treasury Department for several years and will do much to unclog the administrative machinery. Very important, also, and eminently just is the allowing of net losses of one year to be offset against net income of future years. These two changes and the limitation of the tax on capital gain to 12½ per cent in certain cases will do much to unburden business and to remove the serious check upon transfers of property. The allowing of 6 per cent interest upon overpayments of taxes in the hands of the government during settlement of claims and the arrangement for determining loss or gain in involuntary cases of exchange of property are much more fair to the taxpayer than were the former practices. The new law does not, however, go nearly so far as the British act of August 1921 which provides for refunding taxes on paper excess profits that later proved to be in excess of real profits when goods were sold at much below former inventory prices, upon which profits of earlier years had been based. The provision for the relief of executors and administrators from personal liability for the tax after due notice is reasonable. The requirement of returns from all having gross incomes of $5000 or over, regardless of amount of net income, ought to prevent some evasion and the Simplification Board should be able to suggest some improvements in administration. Numerous cases formerly left to the rulings of the Commissioner of Internal Revenue are specifically provided for in the new statute so that this, with the repeal of the excess-profits tax which occasioned a large part of the "Commissioner-made law," will narrow the scope of that official's rulings somewhat but still leave it relatively large.

The increased personal exemptions for heads of families and dependents will be welcome to all taxpayers, especially the smaller ones,

[45] What possibilities this suggests for a slogan in the fall elections this year, for example, "Bonus, beer and sales taxes!"

and are probably not without political significance. The exemption of $300 in dividends and interest from building and loan associations is of doubtful propriety though not very important. The failure to tax large gifts as much as inheritances, as provided by the Senate bill but struck out in conference, leaves a large opportunity for the evasion of the estate tax, an opportunity which is great in any case. The similar fate of the Treasury's proposal with reference to increased taxes on liquors withdrawn from warehouses for unlawful purposes is a sad comment not only upon the violators but also upon the makers of the law.

One very noteworthy feature in the preparation and enactment of the new law was the almost constant consultation by the Treasury and also by the revenue committees with a well-known and able authority on taxation, Professor T. S. Adams, who had served in a similar capacity during the preceding administration. Another fact, not so complimentary to those responsible for procedure, was that the majority of the Ways and Means Committee excluded all members of the minority party from its sessions while framing the bill, entirely contrary to the procedure of the same committee under the control of the other party during the previous administration. Another practice exhibited, not new but none the less reprehensible, was that of nullifying in the conference committee, whose sessions are more or less secret and without record, the will of the majority which the conferees are supposed to represent. It was charged and it appears that in one instance after another the majority members of the Senate conferees reversed the action of the Senate, not because they were hard pressed by the House conferees, but because they were not in sympathy with the modifications which the agricultural bloc had forced upon them. It appears that in the case of the surtax rates they were prevented from thus receding only by virtue of the fact that the House reversed its own vote and instructed its representatives to accept the Senate amendment.

The real contests in the recent tax revision were over the taxes upon wealth, including taxes upon corporations. If government expenditures could be reduced to a pre-war basis of three quarters of a billion dollars a year, excluding postal expenditures balanced by postal receipts, revenue revision would be a comparatively delightful task. But despite reductions which have been made and further ones which will be made, notably in connection with War and Navy Departments, the Shipping Board, and federal control of transportation, our expenditures will probably be several billions annually for some time to come. The interest on our war debt alone is nearly a billion dollars, or greater than the total net expenditure before the war, and there is

no present prospect of repayment of the European debt, even if that were desirable. No one knows how much more the United States government is going to be called on to aid the railroads and the farmers of the country, not to mention European peoples or nations and others who may need help. In any case, it appears that large revenues will probably be necessary for some years and taxes will consequently be what we call heavy, though really very light as compared with those in European countries. Furthermore, the economic depression reduces the yields of taxes, especially income, profits, and luxury taxes, without any reduction of rates. As a result, the repeal of taxes cannot go very far without the necessity of substituting other taxes to meet requirements. The rub comes when it is suggested that anybody pay higher taxes in these troublous times.

Whether the excess-profits tax should have been repealed or revised is a debatable question, though the weight of authority was on the side of repeal. There is no doubt that, as in force under the law of 1918, it was inequitable as between under-capitalized and over-capitalized corporations, also, as between corporations and partnerships or individual businesses in some cases. It also caused extravagance, especially in connection with high surtaxes in cases of distribution of income, and made the law difficult of administration, because of the complexities of determining invested capital and a proper assessment. The tax is correct in principle, however, and the amendments of the new law regarding final determination of tax, the offsetting of losses of one year against gains of succeeding years, the permissions of partnerships to incorporate in order to reduce their taxes and other provisions go a long way toward removing the grounds for some criticisms against it. Other defects could be eliminated and the experience and records accumulated in the past few years ought to make its administration progressively more satisfactory and equitable. The writer is in some doubt as to how much weight should be given to what are admitted to be grave administrative reasons for its repeal. The experience and arguments of Professor Adams and others are worthy of much consideration but the propaganda for repeal has been so widespread, so prolonged and apparently so well-financed and interested, that disinterested advocates of repeal must have been really embarrassed by the support which their views have received. Much the same might be said with reference to the propaganda for a sales tax and for reduction of the surtax. It is worthy of note that the propaganda against the excess-profits tax enlisted the support of the great majority of smaller, as well as of larger, corporations and businesses, although the partial substitute for it, the increase in the corporation income tax, results in heavier taxes upon practically all

corporations making less than 10 per cent. In times like these, it is probable that many corporations will net less than this, though perhaps some of them would rather pay heavier taxes now than take the risk of excess-profits taxes in more prosperous years.

In his annual report for 1921, published after the passage of the revenue law, Secretary Mellon argues at unusual length against high surtaxes and estate taxes. The arguments are the usual ones. By being high these taxes defeat themselves as producers of revenue and, furthermore, they militate against saving, hinder business and in the long run hurt the masses even more than the wealthy. It is stated, for instance, that such taxes increase the rents of the poor as well as of everybody else, because mortgage loans are not tax-exempt and consequently funds for building are not available in sufficient quantities.

Secretary Mellon estimates that there are $10,000,000,000 of tax-exempt securities in the United States into which the well-to-do may invest rather than pay the higher surtaxes. Others have made much higher estimates. It is evident that no one paying 73 per cent or even 58 per cent upon the upper bracket of his income will invest in 6 per cent or even 10 per cent taxable railroad or industrial securities so long as 5 per cent state and municipal tax-exempt bonds may be bought at par or thereabouts. He suggests a constitutional amendment, but it will probably be some time before three fourths of the state legislatures can be prevailed upon to ratify a federal provision that would weaken so materially the credit of themselves and of their various municipalities. The present writer is not entirely certain that the Supreme Court would now hold, since the adoption of the sixteenth amendment, that the federal government cannot tax the income from state and municipal bonds and also the income received by employees of states and their subdivisions.[46] If this is not to be tested and if an amendment cannot be adopted, it is almost futile or worse to attempt to collect the higher surtaxes of the present law.

Aside from the matter of Treasury receipts, there is some truth, though of course no one knows just how much, in the contention that high income and inheritance taxes check thrift, prevent the expansion of business and thus hurt all classes of people. Secretary Mellon says the small-propertied classes are injured more than those who pay the taxes. There is certainly great need for additional capital now, especially in Europe and the undeveloped parts of the world though, unfortunately, neither we nor Europe seem able to make proper use of what capital we already have. Both could greatly increase production with existing capital if our industrial forces and credit were effectively organized and still more if we diverted less to destructive

[46]See arguments in Seligman's *Income Tax,* especially chapters 5 and 6.

purposes. Frankly, the present writer is in doubt as to what are proper rates for income and inheritance taxes under present circumstances. The rates of the act of 1918 are not excessive from the standpoint of ability to pay, but the surtax rates are not practical administratively, especially with the existing situation in respect to tax-exempt securities. While not agreeing with all that Secretary Mellon says, it is believed that he is within the truth when he says that combined income tax rates of 40 per cent for 1922 and of 33 per cent for 1923 and thereafter are sufficiently high.

Who shall bear the burden of taxes and in what proportion is a perennial question and the answer depends much upon who holds the reins of power. There has been a revolution in this control in the United States since the last law was enacted, though not as much of a revolution as some seemed to think. Just how far further changes will be made during the regular session of Congress will depend in large part upon how far the leaders think they can go without causing too much reaction and this, in turn, will depend much upon the weather in the West and in Europe.

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